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FISCAL IMPACT STATEMENT

LS 7087 | **NOTE PREPARED:** Jan 20, 2006
BILL NUMBER: HB 1399 | **BILL AMENDED:**

SUBJECT: Taxes and Local Finances.

FIRST AUTHOR: Rep. Whetstone | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X GENERAL | **IMPACT:** State & Local
X DEDICATED
FEDERAL

Summary of Legislation: *State Commission on Responsibility and Efficiency*: This bill establishes the State Commission on Responsibility and Efficiency.

Public Debt Instruments: It legalizes certain public debt instruments.

Administration of Public Funds: The bill makes changes in laws governing the adoption of budgets, tax rates, and tax levies and the administration of public funds. It eliminates restrictions on Property Tax Replacement Fund (PTRF) distributions.

Reassessment Increase Credits: It provides a property tax credit for homesteads whenever the assessed value (AV) increases by more than 75% in a general reassessment.

Income Tax Credit: It provides an Income Tax Credit for Sales Tax paid on home heating energy.

Sales Tax: The bill provides a temporary Sales Tax exemption for home heating energy and gasoline. It also permanently caps the price on which Sales Tax is charged on gasoline at $1.50 per gallon.

Motor Vehicle Excise Surtax and Wheel Tax: The bill permits a county income tax council or a municipality to adopt a motor vehicle excise surtax and a wheel tax under certain circumstances.

Local Option Taxes: It authorizes counties, cities, and towns to adopt the following additional local taxes: (1) Income taxes. (2) Food and beverage taxes. (3) Innkeeper's taxes. (4) Sales taxes.

Minimum Wage: The bill increases Indiana's minimum hourly wage.

Cooperative Agreements: It provides alternative procedures for cooperative agreements.

Governmental Service Territories: It permits establishment of governmental service territories.

Cigarette Tax Fund Distributions: The bill changes the Cigarette Tax Fund distribution to cities and towns not located in a consolidated county.

Expansion of Permissible LR&S Expenditures: The bill expands the uses of the Local Road and Street (LR&S) funds.

Cooperative Agreements and Intergovernmental Service Territories: The bill provides for the establishment of cooperative agreements and intergovernmental service territories.

The bill makes other related changes.

Effective Date: Upon passage; January 1, 2006 (retroactive); May 1, 2006; July 1, 2006.

Explanation of State Expenditures: *State Commission on Responsibility and Efficiency*: The bill creates the Commission, which consists of 15 members. Commission members who are not state employees as well as state employees are not entitled to per diem; however, these members are entitled to reimbursement for travel expenses and other expenses incurred in connection with the members' duties. The four legislative members are entitled to per diem, mileage, and travel allowances paid to members of interim study committees established by the Legislative Council. Per diem, mileage, and travel expenses for legislative members are to be paid from appropriations made to the Legislative Council or the Legislative Services Agency.

The Office of Management and Budget (OMB) will staff the Commission. The Commission must annually report to the Governor and, at the request of the Legislative Council, to the Legislative Council regarding property tax reductions and savings and reductions in required distributions for property tax relief from state funds that are the results of local government efficiencies. The OMB may incur a minor increase in administrative expenses. Expenses of the Commission are to be paid from the state General Fund.

Minimum Wage: The state has eight employees who are paid less than $7.00 per hour. The cost to increase the minimum wage from the current rate of $5.15 to $5.65 per hour on September 1, 2006, $6.15 per hour on March 1, 2007, and $7.00 per hour on September 1, 2007, would be approximately $4,448 for FY 2007, and $12,952 for FY 2008. The increase in the minimum salary would also affect wage-related benefits such as social security and retirement benefits.

Local Option Taxes: Under the bill, any local option sales, innkeeper's, or food and beverage tax imposed would be remitted to the Department of State Revenue (DOR) in the same manner as the state Gross Retail Tax is remitted. A local option supplemental income tax would be collected along with the state Income Tax. The DOR would need to revise their individual income tax forms to add on the proposed income tax.

Local Option Supplemental Income Tax Distributions: The Budget Agency would calculate and the DOR would approve supplemental local income tax distributions under the procedures used for local option income taxes. Certifications for each adopting unit's (county, city, or town) supplemental certified distribution would be based on revenue received from the tax in the year previous to the certification and distributed to the unit in the year following certification. The DOR would distribute an annual certified distribution to units on a monthly basis.

The Auditor's office would maintain a special account for each unit adopting a local option supplemental income tax within the state General Fund. Money in the special accounts at the end of a state fiscal year would not revert to the General Fund.

The Treasurer of State would send local sales, innkeeper's, and food and beverage tax revenues monthly to unit fiscal officers. The Department would send certified distributions of local supplemental income taxes on a monthly basis to unit fiscal officers.

Tax Credit for Sales Tax Paid & Sales Tax Exemption for Heating Energy: This bill will increase the administrative costs of the DOR. The DOR will have to amend tax forms, as well as update computer software.

Sales Tax on Gasoline: This bill exempts the sale of gasoline from Sales Tax from the effective date of the bill until July 1, 2007. The bill then requires that Sales Tax on gasoline be computed as the lesser of:

(1) the actual price per gallon multiplied by the number of gallons sold multiplied by 6%; or

(2) $1.50 multiplied by the number of gallons sold multiplied by 6%.

These changes will increase the administrative costs of the DOR. The DOR will have to amend tax forms, as well as update computer software.

Administration of Public Funds. If a petition objecting to the unit's budget is not filed with the proper officers of a unit, the Department of Local Government Finance (DLGF) may not conduct a public hearing and must limit its review to a determination as to whether the unit's proposed levy complies with maximum permissible levy limits. This provision could reduce the DLGF's expenditures by a minimal amount.

Under the bill, after a unit holds a public hearing on an additional appropriation, the unit must send a certified copy of their final proposal and any relevant information with the DLGF. This provision could increase the number of documents that the DLGF receives because some additional appropriations do not have to be approved by or sent to the DLGF.

The bill provides that the DLGF may not consult with the Local Government Tax Control Board when determining whether to authorize bonded indebtedness, if certain procedures relative to filing an objection are not followed.

These provisions should not have a significant impact on the DLGF.

The bill eliminates provisions that would allow the Property Tax Replacement Fund Board to increase the percentage of the credit if the Budget Agency determines that it is necessary under certain circumstances. This provision could limit future expenditures from the PRTF that are above the scheduled percentages.

Rules. The DOR may adopt rules to implement the provisions of the bill. The DOR should be able to cover any expenses associated with rule adoption given its existing resources.

Cooperative Agreements and Intergovernmental Service Territories: The DLGF, when approving a rate and levy fixed by the provider unit, must verify that a duplication of tax levies does not exist within participating units, so that taxpayers do not bear two levies for the same service. The DLGF could experience an increase in administrative expenses associated with this provision. However, the DLGF should be able to cover any additional expenses within their existing level of resources.

Public Debt Instruments. Under existing law, all bonds, notes, evidences of indebtedness, leases, or other written obligations issued by or in the name of any state agency, county, township, city, incorporated town, school corporation, state educational institution, state-supported institution of higher learning, political subdivision, joint agency created under IC 8-1-2.2 (which involves municipal electric utility programs), leasing body, or any other political, municipal, public or quasi-public corporation or in the name of any special assessment or taxing district; or in the name of any commission, authority, or authorized body of any such entity; and any pledge, dedication or designation of revenues, conveyance, or mortgage securing these bonds, notes, evidences of indebtedness, leases, or other written obligations are hereby legalized and declared valid if these bonds, notes, evidences of indebtedness, leases, or other written obligations have been executed before March 15, 2000.

The bill provides that in addition to the above-listed debt instruments, swap agreements and other agreements are legalized. Additionally, the bill includes "boards" with respect to entities to which the provisions apply. The bill further extends the deadline before which the debt instrument must have been executed, from March 15, 2000, to March 15, 2005.

Essentially, these provisions legalize the above-mentioned products. Without the provision, if, for example, a bond was issued without providing the appropriate notice, the bond could be invalidated. The above provisions make the issuer or the entities involved not liable. For example, IC4-4-11-17 provides that the Indiana Finance Authority must hold a public hearing on the proposed financing agreement for an industrial development project after giving notice by publication in one newspaper of general circulation in the city, town, or county where the industrial development project is to be located at least ten days in advance of this public hearing. Under the bill, if the notice was given only six days in advance of the public hearing, the Authority could not be held liable and the bond would not be invalidated.

Wheel Tax / Surtax: The provision regarding the imposition of Wheel Tax and Surtax by municipalities and the provision regarding the indexing of the tax rates for these taxes would result in additional costs for the Bureau of Motor Vehicles (BMV). The BMV would have to change computer programming, operations, and operations manuals to accommodate these provisions.

Explanation of State Revenues: *Tax Credit for Sales Tax paid for Heating Energy:* The bill provides a state tax credit for Sales Tax paid on heating energy for taxable years 2006 and beyond. This credit is estimated to decrease individual AGI Tax, Corporate AGI Tax, Financial Institutions Tax, and Insurance Premiums Tax collections. The total decrease in revenues is estimated to be approximately $73.8 M in FY 2007. The bill allows the credit to be carried forward indefinitely. The impact is estimated to occur only in FY 2007, because the credit is available for any Sales Tax paid after January 1, 2006, and before April 2006 since this bill also provides a Sales Tax exemption for heating energy purchases occurring "upon passage," or approximately after March 28, 2006. Therefore, the estimate above is the approximate amount of Sales Tax that will be paid on heating energy for transactions occurring between January 1, 2006, and March 28, 2006. This credit will be filed on 2006 Income Tax returns that would be remitted by April 2007 and so would affect revenue collections in FY 2007.

The credit is available for Sales Tax paid on transactions involving heating energy used for residential purposes. The amount of the credit is equal to the amount of Sales Tax paid for heating energy in an eligible transaction. The credit is able to be used against tax liability under any of the taxes listed above. The estimates above are based on average billing estimates from the U.S. Energy Information Administration and the Indiana Energy Association. The estimates above will ultimately depend upon the price of heating energy in a particular year.

Sales Tax Exemption for Heating Energy: This bill provides a Sales Tax exemption for heating energy beginning "upon passage," or approximately after March 28, 2006. It is estimated that this exemption will result in a loss of Sales Tax revenue of approximately $123 M in both FY 2007 and FY 2008. There will also be an indeterminable amount of Sales Tax lost in FY 2006, but since the exemption begins in late March of 2006 it is estimated that the loss will not be as significant due to lack of use of heating energy for the remainder of FY 2006. The estimates above and the annual loss of Sales Tax revenue going forward will ultimately depend upon the price of heating energy in a particular year.

Sales Tax on Gasoline: This bill exempts the sale of gasoline from Sales Tax from the effective date of the bill until July 1, 2007. The bill then requires that Sales Tax on gasoline be computed as the lesser of:

(1) the actual price per gallon multiplied by the number of gallons sold multiplied by 6%; or

(2) $1.50 multiplied by the number of gallons sold multiplied by 6%.

It is estimated that these provisions could cause a decrease in Sales Tax revenue of approximately $15.2 M in FY 2006, $265 M in FY 2007, and $34 M in FY 2008. The ultimate impact will depend upon the price of gasoline and the number of gallons sold. This impact could vary if the price of gasoline fluctuates by a significant amount.

Distribution of Sales Tax Revenue: The revenue loss from the Sales Tax changes above would affect the distribution to the following funds.

Sales Tax Revenue Lost (in millions)	**FY 2006**	**FY 2007**	**FY 2008**
General Fund	($7.5)	($190.6)	($77.2)
Property Tax Replacement	($7.6)	($193.8)	($78.5)
Public Mass Transit	($0.097)	($2.48)	($1.0)
Commuter Rail Service	($0.021)	($0.540)	($0.220)
Industrial Rail Service	($0.005)	($0.127)	($0.051)
TOTAL	**($15.2)**	**($388)**	**($157)**

Public Debt Instruments: See *Explanation of State Expenditures* above.

Explanation of Local Expenditures: *Minimum Wage:* The local impact of increasing the minimum wage is unknown, but probably minor. The percentage increase from the current rate of $5.15 would be 9.7% on September 1, 2006, 19.4% on March 1, 2007, and 35.9% on September 1, 2007. The increase in the minimum salary would also affect the local unit's cost of wage-related benefits such as social security and retirement benefits.

Reassessment Increase Credits: The bill provides that when county auditors send certified statements to each political subdivision and the Department of Local Government Finance, the statements must contain information concerning the reassessment increase credits, in addition to other information already required.

Also, county auditors must compute reassessment increase credits. Township assessors must assist county auditors in determining AV increases used to compute the credit. These provisions will increase administrative expenses for all units by an indeterminable amount. It is expected that units will be able to cover any expenses associated with these provisions given existing levels of budgets and resources.

Cooperative Agreements and Intergovernmental Service Territories: The bill provides alternative procedures for cooperative agreements for cities, towns, and counties. The bill also provides for intergovernmental service territories. These provisions could reduce expenditures to the extent that political subdivisions through cooperative agreements or intergovernmental service territories could work more efficiently or avoid duplication of services. However, the savings achieved will vary based on the cooperative agreement undertaken or the service territories established.

Public Debt Instruments: See *Explanation of State Expenditures* above.

Explanation of Local Revenues: *Local Option Taxes*: The following table provides statewide estimates for the local option taxes proposed by the bill. The rates that may be imposed vary between type of tax. However, the table estimates are at a 1% rate.

Type of Local Option Tax	Estimated 2007 Revenue at a 1% Rate
Supplemental Income	$1,184 M
Sales	$920 M
Food & Beverage	$89.5 M
Innkeeper's*	$8.3 M
*65 counties have adopted an innkeeper's tax under current law. Estimates reflect what a 1% rate would raise in those 65 counties only.	

Tax Rates: The following table illustrates the rates that each local tax may be imposed.

Type of Local Option Tax	Rate
Supplemental Income	As specified by ordinance in increments of 0.1% or 0.25%
Sales	0.25%, 0.5%, 0.75%, or 1.00%
Food & Beverage	0.25%, 0.5%, 0.75%, or 1.00%
Innkeeper's	As specified by ordinance (may not exceed 8%)

Adoption Method: Counties would adopt a local sales, food & beverage, innkeeper's, or supplemental income tax under the same adoption procedures of a county imposing the County Option Income Tax (COIT) under current law. (An ordinance to adopt COIT must be passed by the county income tax council after January 1 and before April 1 of a given year.) A city or town would be able to adopt a local tax after March 31, 2007, if their parent county (county in which the majority of territory of the city or town lies) had not already adopted the same tax.

Effective Date: With respect to a local sales, food & beverage, or innkeeper's tax, the effective date would be no earlier than the first day of a month that is at least 45 days after the passage date of the adopting ordinance. Supplemental local income taxes adopted before May 1 in a given year would have an effective date of July 1 in the year of adoption. If the tax were adopted after April 30, the effective date would be January 1 in the year immediately following the year of adoption.

Distribution Method: Revenues from a local sales, food & beverage, innkeeper's, or supplemental income tax would be distributed based on population, location of the collection, or a combination of population and collection location. Certain distribution method exceptions, as detailed in the bill, would be available to adjacent counties and cities or towns in the same county.

Revenue Use: Units adopting a local tax would have to establish a hometown revenue fund (HRF). For the first three years of the tax's existence, revenue would be used to build up a unit's revenue stabilization account. After three years, the stabilization account must have a balance equal to the total amount of revenue received in the first distribution of the tax(es). If after three years, the balance is not sufficient, then subsequent year distributions would be used to achieve the required balance.

If the balance in the stabilization account is sufficient, then in the fourth year of distribution, revenue would be used to provide property tax relief to taxpayers under the percentage schedule in the following table.

For Municipalities	
Per Capita Municipal Property Tax	**% of Revenues Required for Property Tax Reduction**
More Than $450	75%
More Than $350, But Less Than $450	50%
At Least $250, But Less Than $350	25%
Less Than $250	0%

For Counties	
Per Capita Municipal Property Tax	**% of Revenues Required for Property Tax Reduction**
More Than $450	75%
More Than $350, But Less Than $450	50%
At Least $250, But Less Than $350	25%
Less Than $250	0%

If revenue remains after all property tax relief has been distributed, a unit may use any remaining revenue for more property tax relief, additional operating revenue, payment of bonds, leases, or obligations, or any other purpose the fiscal body determines necessary.

NOTE: If a governing body has debt obligation that is payable in whole or in part from tax increment revenues, then revenue from the local taxes would have to be applied to those obligations before the revenue is used for any other purpose.

Max Levy- A unit's maximum levy rate or levy would not be adjusted to reflect the reception of local sales, food & beverage, innkeeper's, or supplemental income tax revenues adopted under the bill. The DLGF would not be allowed to reduce a unit's property tax rate for a fund, property tax levy, or maximum levy by the amount of revenue raised by a local tax adopted under the bill.

Reassessment Increase Credit: Under this provision, the owners of homesteads whose property tax bills rise by specified percentages would be entitled to certain credits. (The next general reassessment is scheduled to take effect with taxes paid in 2012.) The percentage and duration of the credit depend on the percentage increase in the tax bill as summarized below.

Credit Percentage As a % of Tax Increase				
Tax Bill Increase	**Year 1**	**Year 2**	**Year 3**	**Year 4**
75% – 149%	50%			
150% – 224%	67%	33%	0%	
225% or more	75%	50%	25%	0%

Property tax credits that are not funded reduce the tax collections that are distributed to local civil taxing units and school corporations. The bill would require political subdivisions to adjust the AV used in setting rates to eliminate or minimize levy reductions that would otherwise result from the application of those credits. The credit would cause a shift of property taxes from those taxpayers receiving the credit to all taxpayers through an increased property tax rate.

The general reassessment that took effect with taxes paid in 2003 was unique in that it changed the methods used in determining the assessed value of real property and resulted in some large increases and reductions in tax liabilities for some homeowners. Assuming that there will not be any further major changes in reassessment methods and given the fact that annual adjustments to assessments will commence with taxes paid in 2007, it is unlikely that a future general reassessment would cause this magnitude of change again. This provision, therefore, should have minimal impact in the future.

Administration of Public Funds: The bill makes changes in laws governing the adoption of budgets, tax rates, tax levies, and the administration of public funds. Under existing law, after the DLGF proposes adjustments to a unit's levy or tax rate, the unit has one week to specify how the unit will make the reductions in the amount budgeted by fund. The bill provides that the unit has two weeks to respond. The response may include budget reductions, reallocation of levies, a revision in the amount of miscellaneous revenues, and further review of any other item which the DLGF might be in error. This provision could result in more revenue for local units. The specific impact is indeterminable.

If a petition objecting to the unit's budget is not filed with the proper officers of a unit, the DLGF may not conduct a public hearing and must limit its review to a determination as to whether the unit's proposed levy complies with maximum permissible levy limits. This provision could decrease objections to local budgets. The impact would be that local budgets and revenues would likely not be decreased as they might have been with a petition.

Under the bill, after a unit holds a public hearing on an additional appropriation, the unit must send a certified copy of their final proposal and any relevant information with the DLGF. The additional appropriation may not have the effect of increasing the approved tax rate or levy and must be supported by sufficient revenues on hand or unobligated revenues. The additional appropriation will be treated as approved following the adoption of the ordinance or resolution making the appropriation. These provisions could make more revenue available for spending for the local units.

The bill provides that local units may transfer money from one fund to another fund after the adoption of an ordinance or resolution. The unit must publish a notice of a transfer. This provision will allow money from funds to be used for the purposes of other funds which will allow local units to adjust purposes for which the revenue is spent.

The bill provides that the DLGF may not consult with the Local Government Tax Control Board when determining whether to authorize bonded indebtedness, if certain procedures relative to filing an objection are not followed. It is likely that the impact of this provision will result in additional authorization to incur bonded indebtedness because it is possible that fewer objections could be considered.

Cigarette Tax Fund Distributions: The bill changes the Cigarette Tax Fund distribution to cities and towns not located in a consolidated county. Current law requires that the unit deposit 3/14 of the money into the unit's general fund with 11/14 in the cumulative capital improvement fund. The bill provides that the unit may determine by ordinance or resolution the part of the allocated amount that is to be deposited in the general fund. For 2005, the Cigarette Tax Fund received $22.7 M. Two-thirds of the revenue, or an estimated $15 M, went to cities and towns.

Expansion of Permissible LR&S Expenditures: The bill expands the uses for which Local Road and Street funds may be used to include the following:

(1) oiling, sprinkling, snow removal, weed and tree cutting, and cleaning of their highways, including any curbs;
(2) the city's or town's share of the cost of separation of the grades of crossing of public highways and railroads;
(3) the purchase, erection, operation, and maintenance of traffic signs and signals and safety zones and devices; and
(4) the painting of structures, objects, and surfaces in highways for the purposes of safety and traffic regulation.

Background Information: Over the last five fiscal years, local units (cities, towns, and counties) have received, on average, $77.9 M per year from distributions from the Local Road and Street Account.

Wheel Tax / Surtax: Under current law, a county council may adopt an excise surtax and wheel tax in the county. Both taxes must be adopted together. The surtax applies to cars, motorcycles, and light trucks that pay excise tax. The wheel tax applies to all other motor vehicles licensed to operate on roads. The excise surtax may be assessed as a rate from 2% to 10% of the pre-1996 excise tax rates (before lottery subsidies) or at a flat rate from $7.50 to $25. In either case, the rate may not be less than $7.50. A small number of counties were grandfathered under the law before the minimum rate took effect. The wheel tax may be assessed at different rates for different classes of vehicles. The tax amounts range from $5 to $40.

Under this bill:

(1) Municipalities would be able to adopt the taxes within the municipal limits if the surtax and wheel tax have not previously been adopted countywide.
(2) The county income tax council, rather than the county council, would be the county adopting authority in a county that has also adopted the County Option Income Tax (COIT).
(3) The adopted tax rates would be indexed each year beginning in CY 2007, based on the Federal Highway Administration's *Price Trends For Federal-Aid Highway Construction Composite Index*.

Under this provision, municipalities would be able to adopt the taxes within the municipal limits at the same rates as the county could. Revenue from a municipality-adopted tax would be distributed to the county and municipalities as is the case under current law. Municipalities may use the surtax and wheel tax revenue to pay for construction, reconstruction, repair, or maintenance of streets and roads or to pay bonds if the proceeds are used for those activities. In addition, wheel tax revenue may be used for a contribution to a multiple jurisdiction infrastructure authority.

The county income tax council membership consists of the fiscal bodies of the county unit and each city and town in the county. Votes are apportioned based on population. For this purpose, the county unit's population equals the population outside of the cities and towns. In a COIT county, the provision to change the adopting entity for surtax/wheel tax from the county council to the income tax council would include the cities and towns in the decisions regarding surtax and wheel tax.

According to the federal index, the price change has averaged about 2.5% per year over the five-year period from 1999 to 2004. If this trend continues, then surtax and wheel tax rates would be increased by about 2.5% per year under the rate-trending provision.

Thirty-five counties had a surtax and wheel tax in CY 2004. The total surtax revenue was $45.4 M, and the total wheel tax revenue was $5.3 M, for a total of $50.7 M. Two additional counties imposed the taxes in CY 2005.

According to Purdue University's LTAP Center, the maximum annual revenue that could be generated if all counties adopted the maximum rates is estimated at $155 M. The Center also estimates the revenue generated by a more moderate rate schedule to be $115 M per year.

Public Debt Instruments: See *Explanation of State Expenditures* above.

State Agencies Affected: All.

Local Agencies Affected: All.

Information Sources: Department of Personnel Staffing Database; Bob Walls, Department of State Revenue; U.S. Bureau of Census; *Indiana Handbook of Taxes, Revenues, And Appropriations*; Local option income tax estimates; Tom Scott, Program Specialist, Family and Social Services Administration, 232-7015; U.S. Energy Information Administration; Indiana Energy Association.

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